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# Czech Republic

# Trade Policy Monitoring

# Assessment of EU Accession on Major Agricultural Commodities

# 2002

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**Report Highlights: The Czech Research Institute for Agricultural Economics (RIAE) has developed four scenarios to assess the economic impact of EU accession on key agricultural commodities. This report outlines the likely influence of EU accession based on work done by RIAE.**

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*Background:* In January 2002, countries acceding to the European Union (EU) received a proposal from the EU Commission concerning agricultural subsidies. Proposed expenditures over a ten year period are 40.16 billion Euro, which is 2.5 billion Euro less than expected. Originally, this amount was to be split among six new members but now it may be divided among up to ten countries (the Czech Republic, Poland, Hungary, Slovakia, Slovenia, Latvia, Lithuania, Estonia, Cyprus and Malta).

Roughly speaking, the Czech Republic is expected to receive one tenth of the proposed financing or around 4 billion Euro. This means that during the phase in period, Czech farmers will receive much less government support (roughly 25 percent in the first three years) compared to farmers in neighboring Austria and Germany. However, Czech farmers would get full support in ten years. The Czech government is disappointed with this proposal and is trying to negotiate better terms. See E22014 for more details. *End background.*

**Impacts of Czech Accession on the Production of Major Commodities**

In response to a request from the Czech government, the Research Institute for Agricultural Economics (RIAE) has developed four scenarios to assess the economic impact of EU accession on basic agricultural commodities. Underlying assumptions for these scenarios is that the Czech Republic will join the EU in 2004 and by 2005 the Czech agrarian sector will be fully integrated into the Common Agricultural Policy (CAP) controlled European market. Predicted outcomes for years 2004, 2005, and 2006 are compared with the situation in the Czech Republic in the base year 2000 - 2001.

Both the EU and the Czech agrarian markets are influenced by governmental agricultural policies. The level of influence exerted by these policies on farmers in the EU is twice as high as in the Czech Republic. The major tools for market influence include:

- limits of production (production quotas)
- export subsidies
- various types of intervention mechanisms (tariffs, non-tariff trade barriers etc.)
- minimum prices

To understand the economic impact of EU accession, it is important to highlight the differences between Czech and the EU's agricultural policies. The following table compares the level and structure of subsidies in agriculture between the Czech Republic and the EU:

| Indicator (average 2000 - 2001) | CR (in %) | EU (in %) |
|---|---|---|
| EPS - Estimate of production subsidies (ratio between subsidies paid by consumers and subsidies paid by tax payers on 100 CZK/Euro of farmers' income) | 16.5 | 34.5 |
| ratio between direct subsidies influencing the market and general production subsidies | 68.1 | 89.6 |
| - out of which support of market prices | 45.6 | 58.7 |
| Share of structural and other subsidies compared to production subsidies | 31.9 | 11.4 |
| Other services' share (research, genetics, IT, education etc.) on total agricultural subsidies | 15.6 | 8.8 |
| Consumers' share on total agricultural subsidies | 24.0 | 49.4 |
| Tax payers' share on total agricultural subsidies | 76.0 | 50.6 |

The differences between Czech and the EU's agricultural policies (CAP) are:

- the CAP is a very protectionist with measures that directly influence (distort) market and farmers' income
- the Czech government's agricultural policy is more focused on structural measures and on non-market stabilization of farmers' income (this fact along with the higher level of support for 'general services' suggests that the Czech Republic may be well placed to take advantage of the EU's penchant for 'multifunctional' agriculture)
- 50 percent of agricultural subsidies in the EU are paid consumers, whereas in the Czech Republic consumers' share of subsidies is only 25 percent

**Possible Scenarios**

Conditions for the Czech Republic's accession to the EU (the level of subsidies and limits on domestic production) are now being negotiated. Depending on the outcome of the negotiations, the Czech Republic could see several scenarios:

**A. A Lower Level of Commodity Subsidies**
- In 2004 Czech farmers will receive only 25 percent of EU's commodity subsidies (per the January 2002 proposal by the European Commission), 30 percent in 2005 and 35 percent in 2006 (40 percent average between 2006 and 2008); Czech agriculture will be limited by quotas according to Commission's proposal (production limits will be much more important in the future than the level of subsidies)

**B. 100 Percent Level of Commodity Subsidies - Same as EU Farmers**
- In 2004 Czech farmers will receive 100 percent of EU's commodity subsidies; Czech

agriculture will be limited by quotas according to the Commission's proposal

Both scenarios have variations depending on input cost levels in the Czech Republic between 2004 and 2006:

Variation 1. **100 percent level of costs**
- Czech agricultural companies will have the same average unit costs they face today

Variation 2. **80 percent level of costs**
- Czech agricultural companies will be modernized and will produce with average unit costs decreased by 20 percent

In this report 4 scenarios will be discussed: A1, A2, B1 and B2.

It is expected that competition in the Czech food retail sector will continue after 2003. This, along with limited consumer purchasing power, will not permit higher food production costs to be reflected into consumer prices above predicted Consumer Price Index (CPI) levels. It is also assumed that total margins on food retail sales will not exceed 30 percent on average.

The list below highlights major commodities and the existing support systems in the Czech Republic and the EU.

- wheat (supported by direct payments paid by tax payers)
- barley (supported by direct payments paid by tax payers)
- rapeseed (supported by direct payments paid by tax payers)
- sugar beet (indirectly supported by consumers)
- milk (differing support between Czech agricultural policy and CAP)
- slaughter cattle (differing support between Czech agricultural policy and CAP)
- slaughter pigs (indirectly supported by consumers)
- poultry (indirectly supported by consumers)

The above commodities account for 75 percent of total agricultural production in the Czech Republic.

| **Commodity** | **% EPS, average 1998 - 01** | | **P in 2000 - 01** | **P in 2004 - 2006 for different scenarios** | | | |
|---|---|---|---|---|---|---|---|
| | **CR** | **EU** | | **A1** | **A2** | **B1** | **B2** |
| Wheat | -4 | 48 | 121 | 110 | 138 | 147 | 183 |
| Barley | -13 | 57 | 118 | 108 | 136 | 152 | 190 |
| Rapeseed | -12 | 35 | 117 | 105 | 131 | 135 | 168 |
| Sugar beet | 21 | 52 | 121 | 143 | 179 | 143 | 179 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Milk - stable technology | 30 | 47 | 91 | 97 | 121 | 99 | 123 |
| Mil - pasture technology | 30 | 47 | 101 | 110 | 138 | 112 | 140 |
| Slaughter cattle - stable technology | 31 | 82 | 96 | 96 | 120 | 112 | 140 |
| Slaughter cattle - pasture technology | 31 | 82 | 136 | 158 | 198 | 185 | 232 |
| Slaughter pigs | 21 | 22 | 108 | 80 | 100 | 80 | 100 |
| Poultry | 42 | 35 | 98 | 83 | 104 | 83 | 104 |

EPS - estimate of production subsidies
P - profitability

**Analysis and Comments**

*Wheat, barley, rapeseed:*

- currently show high levels of profitability
- have a negative EPS, a result of lower Czech agricultural prices being lower than world prices (producers of these commodities were "subsidizing" domestic consumers)
- after the EU accession these commodities should be profitable
- in scenario 'A' Czech producers would have different terms of trade than EU producers, which could worsen their competitiveness in relation to EU producers
- production of wheat, barley and rapeseed is expected not only to growing; however, the actual production level will be limited by the availability of commodity subsidies

*Sugar*

- both the Czech and EU sugar markets are regulated by production quotas, high tariff protection, and administratively set prices
- there are no direct commodity subsidies
- under these conditions, sugar production in both systems is profitable (21 percent in the Czech Republic in 2000/01)
and is fully paid for by consumers
- after accession, up to a 50 percent increase of farmer prices is expected
- under all of the scenarios considered, sugar producers will be profitable after accession
- it is expected that sugar production will be maintained at the level of the negotiated production quotas (the Commission's proposal is 445,200 MT; the Czech request is 505,000 MT)

*Milk and Dairy*

- there are two technologies for milk production - stable and pasture

- the Czech Republic is more in favor of pasture technology, which is connected with multi-functionality in agriculture
- starting in 2003, investments in stable technology will be necessary
- milk production is in both the Czech Republic and the EU limited by quota
- relatively high levels of domestic protection along with subsidized exports and administratively set prices puts milk among the most supported commodities, predominantly by consumers
- milk production with stable technology is currently not profitable and may not be profitable even after the EU accession (even though farmer prices are expected to rise by 22 percent)
- the Commissions production quota proposal is 2.5 billion kg versus the Czech proposal of 3.1 billion kg

*Slaughter cattle - beef production*

- there are two technologies of production, stable and pasture; stable technology is not profitable
- production of beef is subsidized both in the EU and in the Czech Republic by tax payers and consumers
- beef production will easily reach the quota, and in case of pasture-based production, the quota may even be too low
- current limit of CAP 90 head of cattle /per farm would have a devastating impact on many large Czech farms

*Slaughter pigs - pork production*

- production of slaughter pigs shows a 7-8 percent profitability even without commodity subsidies, which is caused by high farmer prices (at times, even higher than in the EU)
- high prices are a result of a protected market and increasing demand
- pork production is supported mainly by consumers
- after accession, prices could drop by 20 percent, which along with EU requirements to improve animal welfare, will cause pork production to become unprofitable for most farmers
- future pork production will depend on investments and decreasing of costs; some producers will shift out of pork prior to accession

*Slaughter poultry - poultry production*

- very similar situation to pork production
- a large portion of production is done by specialized large companies
- poultry production is currently not profitable, even though farm prices are high (due to tariff and phytosanitary protection of domestic market); this results in very high support by consumers (42 percent ESP, in the EU 35 percent )
- there is no commodity support for poultry in either the EU or the Czech Republic; after accession Czech farm prices are expected to drop by more than 10 percent ; poultry production would then only be profitable if costs are cut dramatically
- investments in this sector will be necessary according to acquis communitaire (conditions of accession) to ensure animal welfare
- under these circumstances, poultry production may be problematic in the future

*Summary of the impacts of accession on Czech agricultural production:*

- The Czech Republic will be competitive only in commodities that are not dependent on labor quality (management) and technology - this generally means field crops. Animal production will depend on commodity support and subsidies.

- Average input costs for Czech producers are relatively high due to low efficiency. Improvement in management by large agricultural companies will be necessary.

- After accession, conditions for plant production will be much better than for animal production. Cattle breeding will play an important role in the 'multi-functionality' of agriculture in areas with poor production conditions (or about 60 percent of Czech agricultural land). Production of pork and poultry will be threatened and will depend on producer investment and modernization of plants.

- The following areas will grow: production of organic products (from a current level of 3 percent of agricultural land to 10 percent), production of regional speciality products, and non-food industrial products (e.g. biodiesel).

(Exchange rate: April 2002: 1 USD = 36 CZK)